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South Africa: Regional Economic Ties and Leverage

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A Research Paper

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ALA 85-10064
June 1985

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South Africa: Regional Economic Ties and Leverage [redacted]

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A Research Paper

This paper was prepared by [redacted] Office of African and Latin American Analysis. It was coordinated with the Directorate of Operations. Comments and queries are welcome and may be directed to the Chief, Southern Africa Branch, ALA, [redacted]

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South Africa: Regional Economic Ties and Leverage 25X1

Key Judgments

Information available as of 10 June 1985 was used in this report.

South Africa dominates a regional network of economic ties that provides significant economic benefits to all of South Africa's closest neighbors except Angola. For South Africa itself, these economic relations are an important source of foreign exchange earnings and migrant labor, provide some protection against economic sanctions by virtue of the damage that sanctions would do to neighboring states, and serve as a conduit for maintaining working relationships with countries that do not recognize the Republic diplomatically. Pretoria has also cited economic ties to neighboring states as examples of its role as a catalyst for regional development. 25X1

The network of economic ties that crisscrosses southern Africa is multifaceted. As it is:

- Six of the region's 10 countries are landlocked and depend on a regional rail system heavily dominated by Pretoria.
- Most countries in the region depend on South Africa for a wide array of goods—ranging from chemicals to grains—and as a source of investment funds.
- A number of countries in the region are linked to Pretoria through formal institutional ties that in some cases provide badly needed sources of revenue.
- South Africa provides a major market for labor that neighboring economies would otherwise find difficult to absorb. In 1983, for example, there were more than 240,000 legal foreign workers in South Africa and many more who were working illegally.

Regional economic ties also extended to a wide array of other areas, such as communications, electrical supply, and technical advice. 25X1

Because of the economic and political benefits these ties generate, we believe that Pretoria is selective in using its economic leverage against neighboring states. For example, we estimate that South Africa earned approximately $1.2 billion net foreign exchange from trade and other economic ties to neighboring countries in 1983. Moreover, the implicit threat of economic or military retaliation generally has been enough to circumscribe the range of actions that these countries pursue in expressing antipathy toward Pretoria's internal racial policies. 25X1

While regional economic ties are substantial, the prospects for their further growth appear mixed in the near term. Economic recession and smaller food imports as a result of better rains will tend to reduce the dependence of the black states on South African transport facilities for the time being.

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Slow economic growth in South Africa over the remainder of this decade probably will inhibit the expansion of regional trade and investment. In our view, however, Pretoria recognizes that economic relationships with neighboring states are an important source of foreign currency earnings and will continue to target these markets. Moreover, we believe that southern Africa's less developed nations are unlikely to improve their economic prospects significantly without increased economic ties to South Africa. 25X1

Over the longer haul, any major expansion in the scope of the region's current economic ties—including key projects to obtain water for South Africa's industrial heartland—depends on establishing and maintaining a separation between economic relations and political and security concerns—not an easy task in the face of deep mutual distrust. South Africa's neighbors publicly have justified their economic relations with it on the grounds of necessity and have attempted unsuccessfully to reduce their dependence. Pretoria, for its part, is almost certainly wary of establishing even more extensive economic ties that might increase its neighbors' potential counterleverage. Thus, while the significant benefits generated by expanded economic links will offer a powerful magnet for closer relations, political tensions are likely to make the process one full of stops and starts. 25X1

Western promotion of regional economic ties in southern Africa, as well as other mediation of differences between Pretoria and its neighbors, is not without risks, in our view. Frustration in Maputo over the limited economic and security gains to date from the South Africa–Mozambique nonaggression accord may damage prospects for Mozambique's broader rapprochement with the West. Likewise, if Pretoria eventually achieves its objective of becoming the center of a regional constellation involving the black states of southern Africa, the United States may be seen as having acquiesced in, and perhaps promoted, the new order. We believe that such association with South African interests would hurt US influence in black Africa unless Pretoria's neighbors reap significant economic and security benefits from the relationship. 25X1

Even if regional linkages do not grow, South Africa's dominant influence over the economies of its neighbors limits, in certain respects, Western flexibility in dealing with Pretoria. Effective economic sanctions, for example, would almost certainly send trade and financial shockwaves through neighboring black states. Moreover, South African threats to conserve resources in the face of effective sanctions by reducing the flow of oil and other goods to its neighbors are credible, in our view. Such retaliation would further damage these already weak economies and increase their need for Western economic assistance. 25X1

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Introduction

South Africa has forged a network of economic ties to neighboring countries that includes transportation links, trade, investment, institutional relationships, and a substantial flow of migrant labor. The vast difference in size and level of economic development between the South African economy and those of neighboring countries guarantees that these ties are dominated by South Africa (see table 1). This paper examines the nature and benefits of South Africa's regional economic ties, the constraints on Pretoria's use of economic leverage, and the likely future direction of regional economic relations. Bilateral economic relations, the special case of Namibia, and the role of the Southern African Development Coordination Conference are discussed in detail in separate appendixes

Regional Economic Ties

Transportation Linkages

Transport linkages, in our view, are South Africa's greatest source of economic leverage over its neighbors.[1] Six of the region's 10 countries are landlocked and therefore dependent on the regional rail system to reach overseas markets. South Africa has 75 percent of the region's rail network and its most efficient ports, according to an academic study. The state-owned South African Transport Services (SATS) encourages use of its rolling stock, rail lines, and ports by neighboring states. All of the southern African countries except Angola rely on SATS facilities to some extent. During the past few years, South Africa's transport system has handled a large proportion of foreign trade for Malawi, Zambia, Zaire, and Zimbabwe because of the impact of insurgency and poor maintenance on Mozambican and Angolan railways and the operating problems of the Tazara Railroad (see figure 1). Botswana, Lesotho, and Swaziland consistently have depended on South Africa's railways and roads for the bulk of their external trade. South Africa also provides several of its neighbors with transport personnel, finance, and technical advice. 25X1

If Pretoria chose to exercise this leverage through, for example, an embargo of rail shipments from South Africa, we believe that the greatest impact would be on its neighbors' oil supplies. Few alternatives exist. The Beira-Mutare pipeline supplying finished petroleum products to Zimbabwe traverses an area of heavy guerrilla activity in Mozambique and, according to US Embassy reports, has been sabotaged repeatedly. Based on logistics, we estimate that the refinery at Ndola in Zambia's copper belt could produce petroleum products for much of the region, 25X1
but, without access to crude oil shipments through South Africa, feedstock would have to be piped in at a high cost from the Tanzanian port of Dar es Salaam.[2] Even if the Benguela Railroad through Angola were operable, Angolan crude is too heavy for use in the Ndola refinery, 25X1
Moreover, no matter what arrangements 25X1
were made, Pretoria could forestall shipments to Lesotho because of the need to cross South African territory. 25X1

Zambia and Zaire would also suffer economically from a South African rail embargo because they would be unable to maintain their current level of mineral exports without the use of SATS facilities. Zaire's combined rail-river system from Shaba to Matadi (Voie Nationale) is already used to capacity

[2] Zambia already has had periodic difficulty obtaining adequate crude oil supplies for the refinery due to foreign exchange shortages, and, as a result, normal shipments of gasoline to Malawi were disrupted for two months last year. According to US Embassy reporting, Lilongwe became so frustrated with the unreliability of supplies from Ndola that it has replaced them with cheaper and more dependable imports from South Africa. 25X1

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Table 1
Selected Economic Comparisons of Southern African Countries

	GDP 1983 (*billion US $*)	GDP Per Capita, 1983 (*US $*)	Average Annual Real Growth in GDP, 1978-83 (*percent*)	Total Trade, 1982 (*billion US $*)	Employment in Manufacturing (*thousand persons*)	Populations 1983 (*million persons*)
South Africa	79.0	2,600	2.5	34.0	1,474	30.9
Other southern Africa	26.6	290	0.6	13.2	549	91.7
Of which:						
Angola	3.6	470	0	2.8	10 [a]	7.6
Botswana	0.9	900	12.1	1.0	4	1.0
Lesotho	0.4 [a]	290	10.0 [a]	0.5	4	1.4
Malawi	1.3	200	3.3	0.5	42	6.6
Mozambique	1.5	120	−3.0 [a]	0.4 [a]	20 [a]	13.0
Swaziland	0.7	1,170 [a]	3.5	0.7	14	0.6
Tanzania	4.6	220	−0.4	1.7 [b]	100	20.4
Zaire	3.6 [a]	120	0	0.9	100	31.2
Zambia	3.4	540	0.6	1.9	80	6.3
Zimbabwe	6.5 [a]	800	4.2	2.8	175	8.1
SADCC [c]	22.9	380	0.7	12.3	449	60.0

[a] Estimated.
[b] Data are for 1981.
[c] SADCC includes all of the listed countries except South Africa and Zaire.

Sources: IMF; *International Financial Statistics*; government data.

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given low water levels on rivers, and the Tazara Railroad has proved notoriously unreliable, according to press reports. Significant loss of mineral exports would cause serious hardships for these foreign-currency-strapped economies.

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Trade

Beyond simply the transportation linkages, most of the southern African countries depend on South Africa for chemicals, chemical products, machinery, manufactures, grain, and other food. According to regional economic statistics, the magnitude of South Africa's trade with its neighbors has fallen somewhat during the past four years—primarily as a result of the prolonged drought and deep recession that have plagued southern Africa—but this tie remains important to Botswana, Lesotho, Malawi, Swaziland, and Zimbabwe (see table 2). We believe that exports from South Africa to neighboring states include some hidden transshipment of goods to other African countries, but the data are not available to separate this component.

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South Africa has continued to supply corn at market rates to Botswana, Lesotho, and Swaziland, even though Pretoria was forced to cancel other major export contracts for grain because of four consecutive years of drought. According to press reports, South Africa also supplied some 12,000 metric tons of wheat to Zambia in 1984, although corn and wheat sales to Zaire, a traditional customer, were suspended.

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Figure 1
Percent of Rail Traffic Routed Through South Africa, 1983

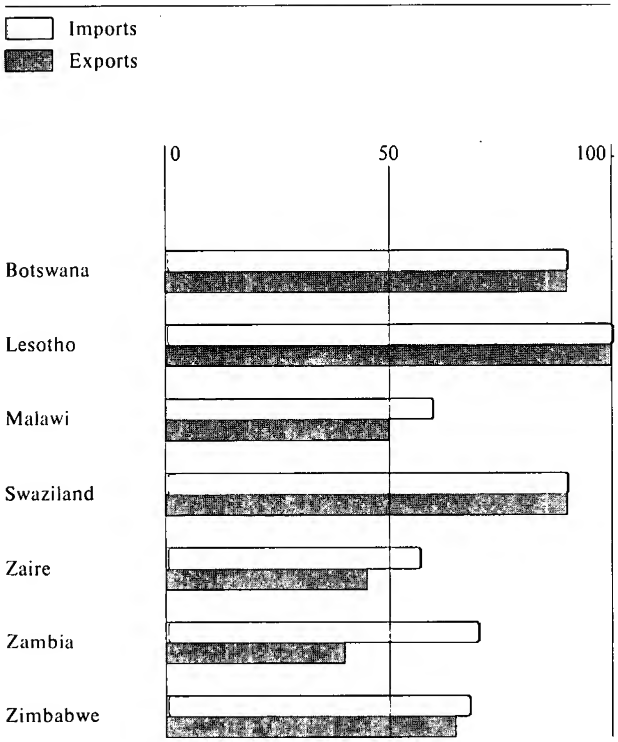

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Table 2
South Africa: Trade With Selected Neighbors

Million US $

	1979	1980	1983
Total nongold exports	11,238	12,553	9,290
Exports to neighbors	**1,600**	**2,430**	**2,260**
Botswana	280	600	670
Lesotho	250	450	580
Malawi	165	160	120
Mozambique	125	50 [a]	40 [a]
Swaziland	300	560	450
Zambia	80	170	140 [a]
Zimbabwe	400	440	260
Total imports	11,591	18,200	14,357
Imports from neighbors	**337**	**492**	**373**
Botswana	30	33	60
Lesotho	20	24	13 [a]
Malawi	10	9	19
Mozambique	25	15 [a]	10 [a]
Swaziland	50	106	80
Zambia	2	6	6 [a]
Zimbabwe	200	299	185

[a] Estimated.

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Sources: Press and US Embassy reports; government data; analyst estimates.

Southern Africa's developing countries, in our view, probably would have little difficulty finding alternative sources for the food and manufactures they currently import from South Africa. Severe transport problems would arise, however, and the higher costs of importing from outside the region would compound existing foreign currency shortages. Moreover, the countries would lose the benefit of one year of credit offered by South Africa on many of its regional sales, according to press reports.

Institutional Ties

A third important source of economic dependency is the institutional relationships that several of the black states have with South Africa through the Southern African Customs Union (SACU) and the Rand Monetary Area (RMA), according to US Embassy reporting. SACU revenues collected by Pretoria for Botswana, Lesotho, and Swaziland include a substantial grant, and provide one-third of Botswana's government revenues and 60 to 70 percent of the government revenues of Swaziland and Lesotho. Moreover, SACU

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reduces administrative costs for Pretoria's neighbors by sparing them the burden of separate customs and excise systems.

Swaziland and Lesotho also are members with South Africa in the RMA. Under this agreement, the Swazi and Lesotho currencies are tied to the South African rand. The rand is legal tender in Swaziland and Lesotho, and the local currencies are backed by interest-bearing deposits in South Africa's central bank. Swaziland and Lesotho also receive annually some $1.9 million and $1.5 million, respectively, in compensation for the loss of interest that could have been earned from rand in circulation in their economies, according to an academic study. The South African central bank manages holdings of gold and foreign exchange for the entire RMA. The RMA agreement provides for assured access to South African financial markets by the two smaller countries. In exchange for these benefits, Swaziland and Botswana have sacrificed effective control over their monetary policies, according to the study.

Employment
Substantial labor remittances earned by migrant workers create another economic tie that binds some of Pretoria's neighbors to South Africa. During 1984 alone, official data show that the 195,000 foreign black workers employed in South African gold and coal mines remitted over $200 million through savings programs run by the mining industry (see figure 2). In 1983, remittances to countries of origin by all 240,000 foreign workers legally employed in South Africa—excluding those from Namibia and Pretoria's nominally independent black homelands—totaled almost $480 million, up from $400 million in 1980, according to an academic study. Moreover, between 200,000 and 700,000 illegal migrants work in South Africa, mostly in the agricultural sector, according to another study.

The presence of these foreign workers gives Pretoria potential leverage by threatening to expel them, a point driven home recently by the firing of some striking miners from Lesotho. Most migrants from neighboring black states, if forced from South Africa, would have little choice but to return to subsistence agriculture in their home countries, in our view. From Pretoria's perspective, high unemployment throughout southern Africa would by and large prevent any

Figure 2
Origins of Workers Employed in South African Gold and Coal Mines, 1984 25X1

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serious labor shortages if it sends back migrant workers from any single neighboring country, although the loss of semiskilled black miners from Lesotho probably would cause some initial hardships for South African mines. 25X1

Investment
In addition to employing substantial numbers of workers from throughout the region, South African firms have constituted a major source of foreign investment in neighboring economies. South Africans own the bulk of foreign investment in Botswana, Lesotho, and Swaziland, some one-third of direct foreign investment in Zimbabwe, and major shares in Zambia's key copper mining industry, according to US Embassy estimates and press reports. Regional 25X1

investments by South African companies cover a broad range of products and services, including food production and marketing, tourism, minerals, and wood products. Most important are the extensive holdings in mineral extraction and marketing by Anglo-American, De Beers, and other South African companies. South African retail trade chains and construction and engineering firms also operate in neighboring states. [redacted]

We believe that South African investment does not provide Pretoria with significant leverage over its neighbors. Action by Pretoria to cut these business ties and force South African companies to divest their regional holdings, in our view, only would accelerate a process already under way. Several of South Africa's neighbors, particularly Zambia and Zimbabwe, have sought since independence to reduce South African investment. Many companies have been gradually bought out by local interests or partially or totally nationalized, according to press and Embassy reports. In other cases, multinational corporations have shifted their southern African holdings from South African subsidiaries to their main offices, according to press reports. [redacted]

Other Economic Ties

South Africa's economic ties to its neighbors include supplying several of them with basic services—particularly external communications and electricity—that their own economies cannot provide. South Africa's Electric Supply Commission (ESCOM)—a state-run enterprise—supplies electricity to Botswana, Swaziland, Mozambique, and Lesotho. In 1981, according to official data, ESCOM exported 586 billion kilowatt-hours of electricity to neighboring countries, less than 1 percent of its output. Pretoria could threaten to cut electric power exports to neighboring countries, an important source of vulnerability for Lesotho, Mozambique, and Swaziland (see figure 3). [redacted]

South Africa also provides its neighbors with vaccines and other support in fighting human and livestock disease, technical advisory services for railways and transport facilities, and a steady stream of tourism-related revenues, according to South African Government publications and press reports. Pretoria has regular contact with neighboring states on the issue of water rights and pollution of common rivers, according to press reports. These miscellaneous economic ties appear less plausible as sources of economic leverage, in our view, because their impact would be felt only over a long period of time. [redacted] 25X1

Regional Economic Policies

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Limits of Economic Leverage

The record shows that, despite South Africa's enormous economic leverage over neighboring states, Pretoria is very cautious in using its regional economic ties as an instrument of coercion. In our view, it has bluffed and blustered, but rarely done more than impose some minor economic sanctions on recalcitrant neighbors. We believe South Africa clearly recognizes the value of maintaining and expanding its regional economic relations and generally has used economic levers in ways that do not seriously undermine existing or potential economic ties:

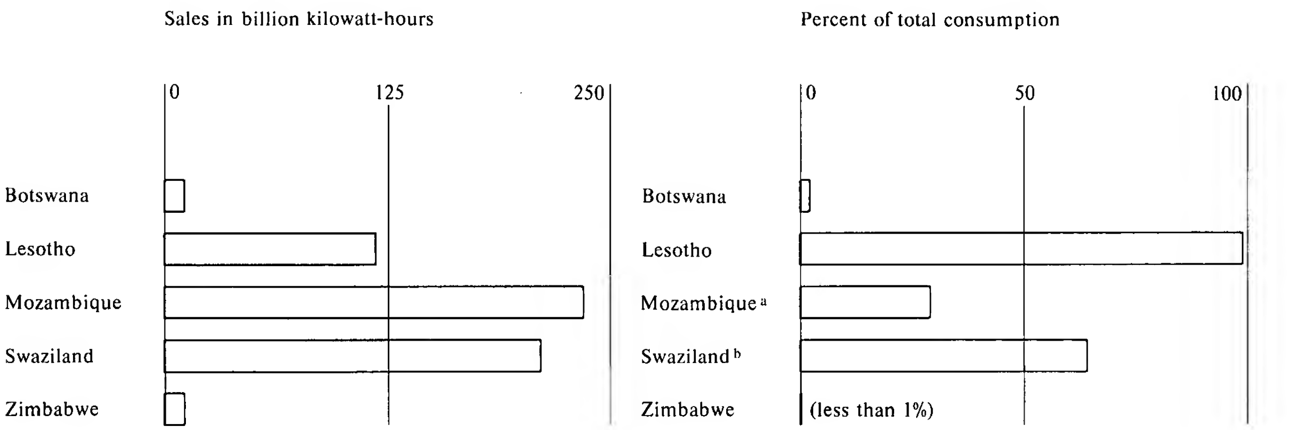
- South Africa has tried several times to link its continued participation in the Botswana soda ash project to the willingness of Gaborone to sign a mutual nonaggression accord with Pretoria, according to US Embassy reporting. Although Gaborone refused to accede to Pretoria's demand, the project appears to be moving forward. 25X1

- In April 1981 South Africa recalled 24 diesel locomotives on loan to Zimbabwe, claiming that they were needed for the busy season and demanding ministerial-level negotiations on transportation problems, according to press and US Embassy reporting. Despite Harare's unwillingness to meet publicly at the ministerial level with the South African officials, Pretoria subsequently returned the locomotives, although we believe it did so partly as a result of US pressure and with Zambia serving as an intermediary. 25X1

- Pretoria occasionally publicly stresses its role as a food supplier and hints at food as a potential weapon. We have no evidence, however, indicating that South Africa has ever explicitly used the threat

Figure 3
South Africa: Sales of Electricity to Neighboring Countries, 1981

Note scale change



[a] 1982.
[b] 1981/82.

[redacted] 25X1

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of withholding food as a foreign policy weapon, even though a survey of white South Africans in late 1982 revealed that 72 percent favored banning food sales to neighboring countries that support or harbor anti–South African insurgents.

- Pretoria served notice to Harare in March 1981 that it planned to terminate the South Africa–Zimbabwe preferential trade agreement 12 months later. The end of preferential customs duties and quota guarantees on Zimbabwean exports to the Republic would have meant considerable loss of foreign exchange and employment for Zimbabwe. A new trade agreement was negotiated, but Pretoria refused to accept anything less than a ministerial-level signature. [redacted] South Africa has allowed the old trade agreement to continue to operate on a day-to-day basis, according to press reports. [redacted]

Principal exceptions to Pretoria's cautious use of economic leverage are in cases where the targeted countries harbor guerrillas of the African National Congress, South Africa's main insurgent group. In Mozambique, for example, prior to the signing of a mutual nonaggression pact in March 1984, South Africa severed or reduced economic ties and aided antiregime insurgents in retaliation for Maputo's support of the ANC. In less dramatic ways, Pretoria, at one time or another, has used economic leverage to dissuade virtually all of its neighbors from supporting the ANC militarily. For example, in December 1982, Pretoria threatened to cut employment for Basotho miners if Maseru continued to harbor ANC guerrillas, according to press reports. Neighboring countries, in our judgment, have come to recognize that Pretoria

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The Politics of Regional Economic Ties

In assessing the potential leverage and vulnerability that economic ties create, it is important to understand the overall policy environment in which they exist. From a South African perspective, Pretoria is committed, in our view, to maintain its hegemony in the region and to reduce or eliminate the capability of neighboring countries to support anti–South African insurgents such as the African National Congress (ANC). South African tactics for achieving these objectives have shifted periodically based on available opportunities and on the relative influence of two camps within the government favoring different regional strategies.

A review of press as well as US Embassy reporting indicates that moderates in the South African Cabinet, led by Foreign Minister Botha, favor a strategy based on diplomatic initiatives and economic leverage. Many officials in the military establishment by contrast would prefer to rely on the "forward defense" option and use military strength to strike preemptively ANC bases in neighboring countries, according to Embassy reporting. Based on South African policy moves, we believe that those Cabinet members favoring the diplomatic option held considerable sway during the late 1970s, but the firm rejection by neighboring black countries of President Botha's 1979 proposal for a southern African "constellation of states," as well as the election in 1980 of an avowed Marxist as the first Prime Minister of a black-ruled Zimbabwe, led Pretoria toward a more confrontational approach.[a] More recently, in our view, Pretoria's success in negotiating a nonaggression pact with Mozambique has moved the pendulum tentatively back toward the moderate camp.[b] At the same time, neighboring countries have sought their own regional economic integration through the Southern African Development Coordination Conference, a nine-country grouping intended to mobilize donor support for projects that would reduce dependence on South Africa. 25X1

These two broad regional strategies—diplomacy and forward defense—clearly have different implications for the role of economic ties in regional policy. Proponents of the forward defense strategy have tended to favor the use of regional economic ties primarily as a tool for keeping neighboring states weak and compliant. For example, several senior South African officials publicly have expressed the 25X1 *view that efforts by Pretoria to encourage regional stability and to use economic inducements to obtain its neighbors' good will only risk strengthening fundamentally hostile regimes. Moderates in the Cabinet believe, according to US Embassy reporting, that regional economic ties can be used to complement diplomatic ventures in southern Africa by employing two basic tactics: create and reinforce regional economic relationships and use economic carrot-and-stick leverage. Despite these differences in emphasis, South African regional economic strategy appears to us designed to reinforce and extend ties to neighboring countries, and in practice it is sometimes hard to distinguish between actions designed to keep neighboring economies weak and those intended to extract specific political concessions.* 25X1

[a] *Botha, who was then prime minister, intended his constellation of states scheme, in our view, as the nexus of Pretoria's regional policies and a vehicle for reducing its diplomatic isolation. This proposal refined earlier concepts of regional detente and called for a complex web of economic, political, and security agreements between South Africa and neighboring countries.* 25X1

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will use the full force of its economic leverage only in those instances where it senses a real threat to South African national security, either because a country is harboring ANC guerrillas, or because it has become excessively strident in condemning Pretoria or pushing for economic sanctions against South Africa. [redacted]

South Africa's reluctance to adopt harsh economic measures—except in extreme cases—coupled with the desire of the black states to avoid the appearance of being under Pretoria's control, has prompted them, in our view, to chart a semi-independent course even at the cost of some economic reprisals, as the examples of Botswana and Zimbabwe show. As a result, economic leverage is less effective for obtaining specific concessions than for drawing broad parameters around the behavior that Pretoria will tolerate before it begins seriously to tighten the economic screws. [redacted]

Even Lesotho, which has the greatest economic dependence on South Africa, has managed to defy Pretoria on several occasions despite South African attempts at economic intimidation:

- In February 1969 Pretoria changed a proffered $1.4 million grant to the Basotho police to a $350,000 loan after Maseru refused to sign an extradition treaty, according to US Embassy reporting.

- Legislation was proposed in the South African Parliament in 1972 to ban South African advertisements on hostile radio stations in neighboring countries, apparently as a warning to Radio Lesotho, according to US Embassy reports. Even so, broadcasts critical of Pretoria continued from the station.

- Between 1976 and 1978 Lesotho suffered from closings and slowdowns of traffic on its border with Transkei—one of South Africa's homelands—in an effort, which we believe had the backing of Pretoria, to gain recognition of Transkei's "independence."

- In January 1977 Pretoria withdrew subsidies on corn and wheat sales to Lesotho following complaints by Maseru to the United Nations over the border problems, according to Embassy reports.

- Pretoria has threatened on several occasions to end its participation in the proposed Lesotho hydroelectric project unless Maseru signs a nonaggression agreement, according to press and Embassy reports. At present, no pact has been signed.

Lesotho has been able, in our view, to weather South African economic intimidation largely because Pretoria restrained its use of economic coercion. Although several of South Africa's threats or actions were potentially very costly for Lesotho's small economy, they by no means represented the full extent of South Africa's economic leverage. [redacted] 25X1

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Pretoria occasionally has attempted a different form of economic leverage by offering neighboring states economic benefits to reward desirable behavior and reinforce South Africa's diplomatic gains: 25X1

- According to US Embassy reporting, South Africa has provided generous economic and military assistance to Malawi, the only black African country that maintains formal diplomatic relations with Pretoria.

- South Africa offered Mozambique technical and security assistance in restoring the Cabora Bassa hydroelectric installation, renovating rail lines and ports, and revitalizing agriculture, tourism, and fishing, as well as the use of revolving credit facilities, after Maputo signed a formal nonaggression accord, according to press and US Embassy reporting.

- According to US Embassy reports, Pretoria has offered new economic assistance to Swaziland, in our view, rewarding its efforts to remove its territory from use as a launching pad for ANC operations.

Not surprisingly, those neighboring states that receive economic recompense from Pretoria pay a diplomatic cost in the eyes of other African nations. Malawi, Mozambique, and Swaziland all have been accused publicly, at one time or another, of "selling out" to Pretoria, according to press reports. [redacted] 25X1

Strategy of Symbiotic Benefits

Regardless of the reactions in neighboring states, we believe that Pretoria is restrained in using its economic leverage because regional economic relations afford South Africa an important source of financial benefit and diplomatic protection.

Financial Benefits. Based on a survey of press and US Embassy reporting, we estimate that South Africa earned approximately $1.2 billion net foreign exchange from trade and other economic ties to neighboring countries in 1983. In addition to a $1.9 billion trade surplus with neighboring countries, South Africa received about $100 million annually in rail and harbor fees. Against these foreign exchange earnings, these sources indicate that South Africa paid about $800 million in labor remittances; grants to Lesotho, Swaziland, and Botswana in the form of inflated customs union payments; and rail and harbor fees to Mozambique.

Diplomatic Protection. While South Africa's regional economic relations give it leverage over its neighbors, they also afford it some protection against economic sanctions by virtue of the damage that such sanctions would also inflict on neighboring states. South African Government officials have been quick to point out publicly that effective economic trade sanctions or boycotts against South Africa inevitably would hurt neighboring states because of close regional economic ties. Moreover, President Botha and other senior officials have threatened publicly to retaliate for sanctions by reducing employment of foreign workers.

South Africa's regional economic ties also provide vital channels for communication with political and business leaders in neighboring countries, according to press and US Embassy reports. In several cases, South African trade missions or business groups have served as substitutes for embassies in countries that do not recognize Pretoria diplomatically.

For their part, neighboring black states have been ambivalent toward economic sanctions against South Africa. Although publicly voicing some support for the idea of sanctions undertaken by Western countries, most of these neighbors have also been quick to cite the negative impact that effective sanctions would have on their own economies, as well as to point out their inability to take the lead in such action by cutting economic ties with South Africa. 25X1

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Outlook for Expanding Economic Ties

The prospects for still closer economic ties between South Africa and neighboring countries appear poor for 1985. Real economic growth, in our judgment, is unlikely to exceed 2 percent for South Africa and most surrounding black states. South Africa's economy has entered a sharp economic downturn triggered by government austerity measures intended to slow persistent double-digit inflation and by a recent decline in the world price of gold, which accounts for 48 percent of the country's export earnings, according to South African Government data.[3] Economic growth in most neighboring countries will be limited by low world prices for the region's commodity exports, the recession in South Africa, and insurgencies that have disrupted economic activity in Angola and Mozambique. Economic recession—and smaller food imports as a result of better rains in much of the region—will tend to reduce intraregional trade and dependence on South African transport facilities. 25X1

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Despite these problems, South African public statements and actions suggest an interest in providing aid and investment funds through new or expanded regional organizations similar to the customs union agreement with Botswana, Lesotho, and Swaziland. Pretoria created the Development Bank of Southern Africa (DBSA) primarily to fund projects in its own 25X1

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tribal homelands, but membership was also offered to neighboring countries, an offer spurned on the grounds that such membership would imply recognition of those homelands granted "independence." Another proposal for a regional economic organization that has been vetted by Pretoria is a center for the resolution of financial disputes, according to a US Embassy report. Participating countries would sign an agreement guaranteeing repatriation of profits from intraregional investments and empowering the center to arbitrate related disputes. We believe that a mechanism of this sort could open the way for new South African investment in neighboring countries, provided that those countries were willing to allow greater private South African involvement in their economies.

Potential new economic ties are by no means limited to multilateral economic organizations. Indeed, Pretoria so far has found less resistance to economic initiatives based on bilateral arrangements than those based on new multilateral organizations, which black states, in our view, often interpret as building blocks for the "constellation of states." New bilateral economic ties could include any of several major proposed projects involving South Africa:

- Botswana is interested in exploiting its soda ash deposits for sale to South Africa's glass, aluminum, and paper industries. It has been estimated that the project would cost over $200 million, including related infrastructure, according to press reports. The project would address South Africa's interest in securing a local supply of soda ash.

- Several regional hydroelectric projects involving South Africa are under consideration. The Lesotho Highlands Water Project would divert water from Lesotho to South Africa's industrial heartland in Transvaal Province, an area that will be critically short of water by the mid-1990s unless the project is built, according to US Embassy reporting. Press reports indicate that Pretoria also is interested in obtaining water for the Transvaal from the Zambezi River by constructing an aqueduct through Botswana.

- Mozambique's Maputo port could be repaired and modernized and made again a key port for South Africa's overseas trade, according to US Embassy reports.

Any of these projects could provide significant foreign currency earnings for the black state involved, as well as important economic benefits for South Africa. Moreover, most of these projects could be undertaken with only token amounts of South African Government finance, the bulk of the funds coming from private investment or the World Bank. 25X1

Over the long haul, the prospects for greater regional economic ties are likely to increase. Although stagnant gold production is likely to hold South African 25X1 economic growth to an average of 3 percent or less for the remainder of this decade, the country's relatively low foreign debt and good reputation among banks give it access to some funds for private and government investment and loans to neighboring countries. Southern Africa's less developed nations are unlikely to solve their foreign currency shortages in the foreseeable future, making improved access to South African loans and investment tempting. Moreover, we believe that from the South African perspective the need to secure water supplies for Transvaal Province and the importance of foreign currency earnings from neighboring countries are sufficient inducements to guarantee that expanded regional economic ties will be an important objective. 25X1

Any major expansion of economic ties involving South Africa and neighboring states depends, however, on establishing and maintaining a separation between economic relations and political and security concerns—not an easy task in the face of deep mutual distrust. South Africa's neighbors have publicly justified their economic ties to it on the grounds of necessity and have attempted unsuccessfully to reduce their economic dependence on South Africa through the Southern African Development Coordination Conference. Pretoria, for its part, has proved wary of

establishing economic ties that might overly enhance its neighbors' potential counterleverage. Thus, while the significant benefits generated by expanded economic ties between South Africa and neighboring states will offer a powerful magnet for closer relations, we believe political tensions are likely to make the process one full of stops and starts.

Implications for the United States

The network of economic ties that crisscrosses southern Africa is the most promising centripetal force in the region, in our view. Reinforcing those ties, however, will require substantial financial inputs, and South Africa does not have adequate resources to meet the needs of neighboring black states. The willingness of Western nations to provide economic assistance to southern Africa's developing nations may thus play an important role in regional stability. Pretoria already has publicly raised the issue of Western assistance for Mozambique and an independent Namibia. To the extent that regional economic ties can be used to reduce tensions in southern Africa, the position of moderates within the South African Cabinet almost certainly will be reinforced.

25X1

Western promotion of regional economic ties in southern Africa, as well as other mediation of differences between Pretoria and its neighbors, is not without risks, in our view. Frustration in Maputo over the limited economic and security gains to date from the South Africa–Mozambique nonaggression accord may damage prospects for Mozambique's broader rapprochement with the West. Likewise, if Pretoria eventually achieves its objective of becoming the center of a regional constellation involving the black states of southern Africa, the United States may be seen as having acquiesced in, and perhaps promoted, the new order. We believe that such association with South African interests would hurt US influence in black Africa unless Pretoria's neighbors reap significant economic and security benefits from the relationship. 25X1

South Africa's dominant influence over the economies of its neighbors limits, in certain respects, Western flexibility in dealing with Pretoria, in our judgment. Effective economic sanctions, for example, undoubtedly would hurt neighboring economies by virtue of their intimate economic ties with the Republic. Moreover, South African threats to retaliate for effective 25X1
sanctions by reducing the flow of resources to its neighbors are credible, in our view. Such retaliation would further damage these already weak economies and increase their need for Western economic assistance. Pretoria already has threatened publicly to expel illegal foreign workers if the United States imposes economic sanctions, according to press reports. Economic sanctions by Pretoria against its neighbors almost certainly would undermine US peace initiatives in the region and—by lowering the economic benefits of regional cooperation—could trigger a resurgence of support by South Africa's neighbors for the Soviet-backed ANC. 25X1

Appendix A

South Africa: Regional Economic Relations by Country

Angola

Angola's economic ties with South Africa are relatively modest. Trade between the two countries amounts to less than 4 percent of Angolan trade and a fraction of 1 percent of South African trade, according to press reports. Angolan diamonds are mined by a subsidiary of the South African company De Beers and marketed through the De Beers–dominated Central Selling Organization. Diamonds, however, account for less than 10 percent of Angolan export earnings [redacted]

Prospects for new economic ties between Angola and South Africa, in our view, are limited by ideological differences, the guerrilla war in Angola, and the unresolved issue of Namibian independence. If these problems were resolved—which we believe is possible but unlikely within the next couple of years—there is some potential for expanded economic relations. [redacted] The Ruacana hydroelectric facility on the Namibia-Angola border near the Ruacana falls could be revitalized and expanded, with Angola selling electricity to South Africa via the Namibian grid. The revenues from these potential, though in the near term improbable, economic ties could assist a post–civil war economic recovery in Angola. [redacted]

Botswana

Botswana depends on economic ties to South Africa primarily for trade, investment, customs union receipts, transport links, and technical and managerial inputs to its mining industry. South African companies have the lion's share of foreign investment, including contractors, retailers, insurance companies, and wholesalers, according to press reports. The troubled nickel and copper mine at Selebi-Pikwe is owned jointly by the government, Anglo-American of South Africa, and a US firm. Despite the mine's financial losses, the government has persuaded its partners to keep the mine open through a series of bailouts that we believe are intended to sustain its political usefulness as the largest single private employer in Botswana. Botswana diamonds are mined by a subsidiary of South Africa's De Beers and sold through the De Beers–dominated Central Selling Organization. Customs union duties collected by South Africa include a substantial grant above actual duties collected and account for nearly one-third of government revenues, according to Government of Botswana data. Some 40,000 Botswana legally work in South Africa as migrant laborers, helping to relieve Botswana's grow- 25X1 ing unemployment and sending home valuable foreign exchange [redacted] 25X1

One promising investment in Botswana that affords Pretoria new economic ties involves the development of large soda ash deposits for export to South Africa. British Petroleum has begun the initial phases of an investment of over $200 million, according to press 25X1 reports. Pretoria appears to have backed down on 25X1 earlier attempts to link its involvement to Botswana's 25X1 willingness to sign a mutual nonaggression pact, according to Embassy reports. The project offers South Africa a low-cost source of soda ash for its glass, aluminum, and paper industries, and it offers Botswana a significant new source of employment and foreign exchange. [redacted] 25X1 25X1

South Africa would also like to construct a major aqueduct through Botswana to carry water from the Zambezi River to the water-short Pretoria-Johannesburg metropolitan area, South Africa's industrial heartland, according to press reports. The water project could also provide Botswana with water for irrigation and industry, and with an annual revenue estimated to equal some 40 percent of its current GDP, according to press accounts. The project would require the cooperation of the other nations fed by the Zambezi River system—Angola, Zambia, Zimbabwe, and Mozambique, and perhaps an independent Namibia. [redacted] 25X1

Gaborone had hoped to export coal and reduce its transport dependence on South Africa by constructing a $1 billion railway across the Kalahari Desert to either Walvis Bay or Swakopmund on the Namibian coast, according to press and Embassy reporting. Many private analysts believe that this proposal will remain uneconomic at coal prices predicted for the next decade. Alternatively, Gaborone might approach Pretoria about exporting coal through South Africa by utilizing new rail links to be constructed as part of the soda ash project, although this option would also require upgrading of some existing South African rail lines and the expansion of the coal-handling facilities at Richard's Bay.

Lesotho

Lesotho, in our judgment, is the country most dependent on economic ties to South Africa. Remittances from migrant labor account for over 40 percent of GDP, according to Government of Lesotho data. Lesotho is physically surrounded by South Africa, and 95 percent of its imports originate in South Africa, while its exports are all either destined for South African markets or transshipped through South African territory. Virtually all electricity is supplied by the South African Electricity Supply Commission, according to Embassy reports. Customs union duties collected by South Africa for Lesotho—including a substantial grant above actual customs revenue collected—account for 70 percent of government revenues.

Nearly 80 percent of the Basotho working in South Africa are miners, according to World Bank reporting. Since 1977 their number has declined by 9 percent, and this trend is expected to continue as a result of increased mechanization and less reliance on foreign workers. Nevertheless, remittances from Basotho miners appeared to be running at a record rate in 1984, based on scattered data in press reports.

Lesotho has had difficulty attracting foreign investment and tourists in recent years, partly as a result of the subsidies offered by Pretoria for investment in South Africa's black homelands. Maseru has introduced new incentive schemes that may partly offset the detrimental impact of economic competition from the homelands. 25X1

The most important area for future economic ties between South Africa and Lesotho, in our view, is in hydroelectric development. Lesotho has vast hydroelectric potential and surplus water that it could export to Pretoria and Johannesburg. The proposed $1.3 billion Lesotho Highlands Water Project eventually could earn for Maseru revenues equivalent to nearly 30 percent of current GDP and solve South Africa's water needs for its industrial heartland through the early part of the next century, according to academic studies and World Bank reporting. 25X1 Road construction and reservoirs associated with the project should help revive Lesotho's tourist industry, while the electricity generated should reduce dependence on supplies from South Africa. Pretoria threatened to cancel the project if Maseru failed to sign a mutual nonaggression pact but abandoned the threat after the World Bank warned that it would cancel its involvement unless the dispute was resolved. 25X1

Malawi

Malawi and South Africa maintain strong economic ties in the areas of transport, trade, aid, and labor. South Africa's strategic importance for Malawi as a source and conduit for international trade has increased with the interruption of rail and port service through Mozambique. Since 1975 South Africa has been Malawi's largest supplier of imports, including 25X1 petroleum products refined in Durban, raw and intermediate inputs for Malawi's fledgling industrial sector, and, especially in drought years, corn and other food, according to Embassy reports.

25X1

A 1967 trade agreement between Malawi and South Africa provides for duty-free access to South African markets for limited amounts of Malawian tobacco, tea, and other agricultural products. Other Malawian goods are admitted under preferential duties. 25X1 Preferential duties also are applied to South African exports to Malawi. The agreement has boosted South African sales to Malawi more than Malawian sales to South Africa, according to an academic study. 25X1

South African bilateral assistance to Malawi has totaled some $78 million between 1970 and 1984, although no major bilateral aid has been provided since 1982 aside from some emergency airlifts of fertilizer and assistance with Malawi's periodic transport problems. According to the US Embassy, most South African aid to Malawi has taken the form of soft loans for projects for which Malawi could not obtain funding from traditional donors: the Nacala rail link, the new capital city, and an emergency fertilizer loan. Private South African investment has played a relatively small role in Malawi, totaling less than $15 million, according to US Embassy estimates.

Some 17,000 Malawians work in South Africa, according to US Embassy reporting, providing the government with about $12 million per year in foreign exchange through a remittance scheme that withholds 60 percent of the miners' pay. These funds are channeled to the Malawian central reserve bank, which pays the miners in local currency. Malawi has reduced dramatically the number of these migrant workers in South Africa from 176,000 in 1974.

Mozambique

Economic ties between Mozambique and South Africa have decreased substantially since Mozambican independence in 1975. Prior to independence, fees from port and rail shipments, remittances from migrant labor, and tourist spending totaled a South African transfer to Mozambique of more than $200 million annually in foreign currency, according to press and US Embassy reporting. In addition to reducing the number of Mozambican miners employed in South Africa from about 120,000 in 1975 to the present number of about 45,000, Pretoria terminated an earlier agreement under which it had paid Maputo in gold 60 percent of the wages of Mozambican miners, using an official gold price well below the world rate. Maputo handled as much as 7 million tons of South African goods per year, third after the South African ports of Durban and Port Elizabeth, according to press reports. Three-fourths of the traffic through Maputo was South African, which paid about $100 million in harbor and rail revenues annually during the early 1970s. Deteriorating relations with its newly independent Marxist neighbor, however, led Pretoria to expand the Durban port facilities and to build the modern port at Richard's Bay. As a consequence, the tonnage of South African goods shipped through Maputo fell to about 1 million tons in 1983. On the other hand, even during periods of greatest animosity between Maputo and Pretoria, economic ties remained vitally important to Mozambique. Remittances from migrant labor in South African mines alone provided about 70 percent of Mozambique's foreign currency earnings in 1983, according to press reports. 25X1

25X1

Maputo's expectation that its nonaggression accord with Pretoria last year would cripple the Mozambican insurgents and bring significant short-term improvement in the Mozambican economy has not been met. Despite the attention given to trade missions and economic agreements, Mozambique has received only modest economic benefits from its detente with South Africa, and Mozambican guerrillas continue to sabotage the economy. One important benefit for Maputo is credit arrangements with the South African Government and private banks intended to facilitate Mozambican imports of South African food, capital goods, and fishing equipment, according to press reports. Pretoria and Maputo have also signed a new labor agreement covering previously illegal migrant agricultural workers, estimated at about 150,000, according to South African officials. 25X1

25X1

Over the longer term, Maputo hopes to recapture the benefits it gained from relations with South Africa. A South African company has agreed to build a $40 million luxury hotel on Mozambique's Ilha da Inhaca and a second hotel on the mainland. According to press reports, company officials estimate that Mozambique could accommodate 10,000 tourists per year in small groups. Mozambique and South Africa recently signed a fishing agreement that provides financial assistance to the Mozambican fishing industry and allows South Africans to fish in Mozambican waters, according to the US Embassy. Other key areas of potential South African investment include agriculture and minerals. Mozambique and South Africa have also signed a transport agreement, which,

if implemented, will gradually restore Maputo as a major port for South Africa's industrial heartland in Transvaal Province. Under the terms of a third agreement signed in May by Mozambique, South Africa, and Portugal, Maputo will receive hard currency earnings if it can protect facilities associated with the Cabora Bassa Dam, a hydroelectric project in Mozambique. [redacted]

We believe that even these potentially significant long-term gains will be constrained by the uncertain security situation in Mozambique, the high cost of revitalizing Mozambique's impoverished economy, and Pretoria's misgivings about dealing with Mozambique's Marxist government. A representative of a South African business conglomerate recently noted that a major increase in South African use of the port of Maputo would require expensive improvements to make it competitive with South African ports, according to Embassy reporting. The potential for increased employment of Mozambicans in South Africa is limited. Employment in the South African mining sector is not increasing—due to mechanization—and employers are reluctant to replace current workers from South Africa and other countries with Mozambicans. High black unemployment in South Africa will also limit opportunities for the employment of Mozambican workers in other sectors. [redacted]

Swaziland

Pretoria can influence the Swazi economy through its control of economic organizations and arrangements in which Swaziland participates. Swaziland depends on receipts collected by the South African–controlled Southern African Customs Union for some 60 percent of its government revenues, according to official statistics. Swazi membership in the customs union and the Rand Monetary Area entails the loss of control over most aspects of monetary and trade policies. [redacted]

South African investors have been attracted by Swaziland's low labor costs, investment incentives, weak trade unions, and political stability. The two leading South African investors in Swaziland are the Anglo-American Corporation and Kirsch Industries, according to press reports. Anglo-American is the largest investor in Swazi mining and owns the extensive Piggs Peak forests (north of Mbabane). Kirsch Industries and other South African–owned firms provide Swaziland with about 80 percent of its commercially sold corn, and a large portion of its vegetables, milk, and flour [redacted] 25X1

We believe that South Africa's industrial decentralization incentives, which are intended to make the black homeland economies in South Africa more viable by heavily subsidizing companies that locate there, have drawn industries from Swaziland. According to IMF analysis, it would not be economical for Swaziland to attempt to match South Africa's industrial incentives, although Mbabane has introduced more modest incentives designed to offset partially the advantages obtained by industries in South Africa's tribal homelands. [redacted] 25X1 25X1

Landlocked, Swaziland is dependent on South Africa for the transport of virtually all of its imports and exports and 60 percent of its power requirements. Over 90 percent of its imports originate in or are routed through South Africa, according to World Bank reporting. Although a rail line was built in 1964 to transport iron ore from Ngwenya (northwest of Mbabane) to the Mozambican port of Maputo, the depletion of the ore deposits and the inefficiency of transport facilities in Mozambique have prompted Swaziland to rely on routes through South Africa. 25X1
[redacted] 25X1

Although the number of Swazi migrant workers in South Africa has declined in recent years—from 28,000 in 1976 to 12,000 in 1982—Swaziland still depends on remittances from the migrants. Migrant workers are only 2 percent of Swaziland's population, but the importance of their salaries to Swaziland is magnified by the fact that only 15 percent of the population is employed in the cash economy. [redacted] 25X1
25X1

South Africa recently opened a trade mission in Mbabane, and Swaziland plans to open one in Johannesburg, according to the US Embassy. Pretoria has expressed an interest in providing Swaziland with as much as $7 million in development assistance over the

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next couple of years, according to US Embassy sources. A new rail link is under construction from Mpoka to Komatipoort that will shorten the existing route through South Africa. The profitability of this line will depend on South African traffic, including exports of phosphoric acid, phosphate, and timber. Pretoria also has promised to aid in the reconstruction of transport infrastructure damaged by a cyclone in 1984, according to World Bank reporting. Other potential areas of new South African involvement that Pretoria is considering, according to US Embassy reporting, are expanded technical and scientific interchange, training and agricultural research, and the seconding of government experts in areas such as the judiciary, health, customs, and agriculture. [redacted]

25X1

Zambia

Zambian commercial and transport ties with South Africa predate Zambia's independence from Britain in 1964 but have expanded considerably since 1978. President Kaunda reinforced Zambia's growing dependence on imports from South Africa in 1980 by limiting purchases from Europe and the United States in order to take advantage of the lower transport costs and shorter delivery times of South African and Zimbabwean goods, according to press reports. Moreover, Zambia has purchased South African corn in years when the Zambian harvest was poor. South Africa is a close second to the United Kingdom as Zambia's principal supplier of nonoil imports, although recently, in our judgment, trade has slowed again as the result of economic recessions in both countries and Zambia's shortage of foreign exchange. [redacted]

In 1978 Zambian President Kaunda decided, according to US Embassy reporting, that for economic reasons Zambia should once again officially use the region's southern rail system to South African ports via Zimbabwe. Lusaka previously had closed its border with Rhodesia to protest the policies of Ian Smith and to reduce Zambia's dependence on its white-ruled neighbors. Some 40 percent of Zambia's copper and other metal exports destined for international markets is shipped on the southern rail route. The remainder of the exports is sent over the inefficient Tazara Railroad, which runs to the Tanzanian port of Dar es Salaam. Since the mid-1970s, Angolan rebels have closed a third export route, the Benguela Railroad through Zaire and Angola. [redacted]

Private South African investment in Zambia is relatively small. According to US Embassy estimates, Anglo-American holdings account for about 90 percent of this investment. Anglo-American owns 27 percent of the state-controlled Zambia Consolidated Copper Mines, which has lost money because of low copper prices. [redacted] 25X1

South Africa and Zambia have some opportunities to increase their economic ties if political relations allow: 25X1

- Zambia is interested in purchasing electricity from the Cabora Bassa Dam in Mozambique, which would be transmitted over South African and Zimbabwean powerlines, [redacted] 25X1
- Lusaka and Pretoria agreed in principle last year to establish reciprocal trade missions, [redacted] 25X1 25X1
- [redacted] Zambia will buy lubricating oil from South Africa's Durban refinery. South Africa recently supplied diesel fuel to Zambia [redacted] 25X1 25X1 25X1

Zimbabwe

Following its unilateral declaration of independence from Britain in 1965, white-ruled Rhodesia became almost wholly dependent on its economic, political, and military ties to South Africa. Pretoria provided Salisbury with extensive financial support, helped circumvent UN sanctions, and played an important role in Rhodesia's intensifying civil war. South African companies became the dominant force in the Rhodesian business community and held interests in Rhodesian mining, agriculture, corn milling, food processing, brewing, and other concerns. South African grants and soft loans to Rhodesia totaled about $1 billion from 1974 to 1977, [redacted] 25X1 25X1

25X1

Agreement was reached at Lancaster House in London in 1979 to end Rhodesia's civil war and hold national elections, which Robert Mugabe won in 1980. Pretoria for years had considered Mugabe a Communist and a terrorist, and relations with the newly independent black-ruled Zimbabwe rapidly turned sour. Zimbabwe sought to reduce its dependence on South African transport facilities by increasing its use of road connections to the Indian Ocean through Mozambique. The Southern African Development Coordination Conference and the southern and eastern African Preferential Trade Agreement were signed to provide alternate sources of capital and trade. The Government of Zimbabwe purchased majority shares in several South African–owned firms in Zimbabwe. Harare sought to reduce dependence on remittances from migrant labor in South Africa. 25X1

Despite these efforts, South Africa remains Zimbabwe's single most important trading partner and largest foreign investor. The two countries exchange resident trade representatives, and commercial and banking transactions operate smoothly, according to industry spokesmen. Zimbabwe still relies on transportation routes through South Africa for most of its mineral exports. As a consequence, Harare tries to keep its economic relations with South Africa divorced from rhetoric, according to US Embassy reporting. 25X1

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Appendix B

South Africa and Namibia: Economic Ties That Bind

The Namibian economy is virtually an appendage of South Africa's, depending on it for trade, transportation, energy, and substantial budgetary subsidies. Even with the flow of funds from Pretoria, the Namibian economy has performed poorly in recent years. Nonetheless, in our judgment, the current financial cost of Namibia to the South African budget is not great enough to sway Pretoria's decision on Namibian independence. The territory's financial drain is likely to increase, however, and we expect Namibia to become a larger economic liability to South Africa. [redacted]

Namibian Dependence

According to press reports, South Africa supplies about 70 percent of Namibian imports, while approximately 90 percent of the territory's exports are destined for South African markets or transit through South African territory—including Walvis Bay, which Pretoria claims as an exclave of South Africa. Only 2 percent of Namibian land is cultivable, and an overwhelming amount of its food needs are met from the Republic, according to reporting of the US Liaison Office in Windhoek. South African private and public corporations own much of Namibia's vital mining and meat processing industries, and the territory has no independent currency or trade policy. Pretoria contributes some 40 percent of Namibian revenues. [redacted]

Namibia depends heavily on South Africa for transportation and energy. The territory's rail network, which, until May 1985, was owned and operated by a South African state enterprise, is connected only to South Africa. A South African company owns the Namibian airline. Namibia has no petroleum refinery and must rely on South Africa for commercial fuels; exploitation of Namibia's coal deposits is thus far uneconomic, and the natural gas deposits near the border with South Africa are unlikely to be commercially developed until either the independence issue is resolved or Pretoria chooses to guarantee the substantial investments required. Even the hydroelectric project at Ruacana on the Namibia-Angola border is owned by South Africa, according to US Liaison Office reports. [redacted] 25X1

A Floundering Economy

The Namibian economy has slumped under the combined impacts of crippling drought, depressed export prices, severe economic recession in South Africa, and 25X1
the uncertainty surrounding independence. Real GDP fell by 7 percent in 1983, and unemployment rose to over 20 percent of the work force last year, according to press reports. [redacted] 25X1

Prospects for a significant economic recovery in 1985 appear slim, in our view. Markets for diamonds, uranium, and base metals have remained fairly soft, according to press reports. Cattle herds have been devastated by drought and will take years to rebuild. The protracted drought has also raised commercial farm debt to record levels, and, based on press reports, we believe that farmers were very cautious about the amount of land that they planted at the start of the 1984/85 growing season. As a result, corn production was expected to remain low despite heavy rains late last year. Moreover, we believe that private investment will continue to be deterred by the political uncertainty surrounding Namibia's future. White emigration has been a serious problem, according to press reports, and will continue to drain skilled labor from the economy. The longer the time needed to resolve the issue of independence, the greater will be Namibia's economic decline. [redacted] 25X1

Pretoria's Financial Burden

South Africa provided Namibia with about $310 million in financial support—less than 2 percent of the South African budget—during fiscal year 1985, including $220 million in direct budgetary subsidies, $60 million for the operating loss within the territory of the state-run South African Transport Services, and an estimated $30 million in subsidies on Namibian imports.[4] Pretoria may also provide subsidies through other state-owned enterprises, but we lack both proof and relevant data.

In addition to financial support, President Botha has stated that the Namibian operations of the South African Defense Force cost his government between $270 million and $340 million—about 10 to 15 percent of South Africa's defense budget—during fiscal year 1984. We do not have the data to prove or disprove this claim. In our judgment, however, South Africa probably would continue to incur much of this expense for its own defense even in the event of Namibian independence. Moreover, there would be some startup costs associated with establishing new defense installations along the South African–Namibian border.

Some of the economic costs of Namibia are compensated for by foreign exchange earnings that South Africa collects from its economic ties to the territory. Pretoria earns foreign exchange from Namibia's exports, virtually all of which transit South African ports. Although the amount probably has declined in recent years, Namibia exported over $1 billion worth of goods in 1981, the last year for which data are available. South Africa keeps most of the foreign exchange from these exports and remits the earnings to Namibia in rand. The South African economy also receives royalties, profits, dividends, and some worker remittances from Namibia. The magnitude also fluctuates, but we estimate that it topped $400 million annually during the late 1970s.

Pretoria recently has announced that it will establish an interim government for Namibia. In our view, however, any interim government sponsored by Pretoria almost certainly will not be recognized by the international community. As a result, little new foreign aid or investment can be expected. Moreover, South Africa almost certainly would not give Walvis Bay even to a nominally independent Namibia for fear of losing a key bargaining chip if the anti-Pretoria South-West Africa People's Organization (SWAPO) eventually comes to power. In our judgment, an interim government is likely to improve Namibia's economic outlook only if backed by substantial new economic assistance and loan and investment guarantees from Pretoria. 25X1

25X1

Two Key Issues

Two key economic issues will need to be addressed as part of any permanent Namibian settlement: ownership and use of Walvis Bay and disposition of debt accumulated since the South African mandate was withdrawn by the United Nations in 1966. We believe that the manner in which these issues are settled probably will shape future economic relationships between Namibia and South Africa. 25X1

Walvis Bay

Access to Walvis Bay is crucial for Namibian mineral exports, according to press reports and academic studies. The small port of Luderitz, which would belong to an independent Namibia, can only handle shallow-draft vessels, is poorly equipped, and is distant from most of Namibia's mining centers. Expansion of the Luderitz port and continual dredging of its harbor to maintain adequate depth for larger ships would be prohibitively expensive. Moreover, the rail line to Luderitz is in disrepair, and may be closed in order to reduce overall rail system operating losses, according to press reports. The development of Swakopmund, a coastal city north of Walvis Bay, into an alternative port would also be extremely expensive, although it is closer to the mineral deposits. There are no alternative road or rail routes through neighboring Angola or Botswana that could handle Namibia's imports and exports. 25X1

25X1

25X1

[4] The Namibian fiscal year begins in April. 25X1

The Debt Problem

The deterioration of Namibian finances has raised Windhoek's outstanding debt from $12 million in March 1979 to $550 million in February 1984, according to US Liaison Office reporting. We believe that nearly all of this debt is to South African financial institutions and presumably would be repaid in rand, not in foreign exchange. Interest and capital repayment from the Namibian budget is projected to grow from $63 million for fiscal year 1985 to $122 million in fiscal year 1987, according to press reports.

South Africa has unconditionally guaranteed the debt accumulated since 1966, according to an academic study, and would potentially be held accountable for at least $550 million should an independent government in Windhoek repudiate the debt. An opinion by the International Court of Justice in 1971 states that, from the time of the revocation of its mandate in 1966, South Africa has had no authority to grant economic rights or create economic claims in respect to Namibia. An independent Namibia might decide, therefore, that a repudiation of this debt need not call into question its intent to honor its own debts and thus need not close off credit.

In addition to seeking assurances that it will not have to bear the full cost of this debt, South Africa may want a guarantee—either from the new government in Windhoek or the international community—that its $3 billion to $4 billion fixed investment in Namibia will be protected from nationalization, and that future profits can be fully repatriated. A majority-ruled government in Namibia might argue that mineral extraction by South African companies since 1966 has been illegal under international law and lay claim to South African assets as compensation.

Prospects for Postindependence Economic Relations

Based on its economic relations with neighboring black states, we believe that Pretoria would want to maintain cautious, yet pragmatic, economic relations with a black-ruled Namibia following independence:

- Although we expect Pretoria to reduce its budgetary subsidies, we do not believe that it would eliminate them altogether nor otherwise try to cripple Namibia's economy.
- Pretoria is almost certain to expect some political concessions in exchange for any economic assistance that it provides. Although we believe that Pretoria would countenance some anti–South Africa political rhetoric, it would undoubtedly use economic leverage to signal its displeasure with any persistent and strident attacks on South African internal policies.
- South Africa, we believe, would respond quickly with economic coercion, as well as miltary action, should an independent Namibia support the African National Congress or other groups seeking to change South African policies through violent means. In any event, Pretoria probably would eventually push Namibia to sign a formal mutual nonaggression accord. 25X1
- Pretoria probably would offer Namibia economic incentives to formally join the Southern African Customs Union, Rand Monetary Area, and the Development Bank of Southern Africa, and would seek trade and other bilateral economic agreements. 25X1

Pretoria, in our view, can be fairly certain that an independent government in Windhoek will have little 25X1 option but to maintain some continued economic relations with South Africa. Namibia is heavily dependent on resident white South Africans for skilled labor, both in the government and the private sector, and probably will continue to require the involvement of white South Africans for years after independence. Few nonwhite Namibians are adequately trained to move into the middle and lower ranks of the civil service, or to assume jobs as managers, technicians, or large-scale ranchers. Namibian officials privately estimate that a white population of about 50,000, including dependents, will be needed to keep the 25X1 economy functioning. 25X1

Namibia currently is a de facto member of the South Africa–dominated Southern African Customs Union and the RMA. Lacking its own currency, Namibia probably would choose to continue at least de facto membership in these organizations during a transition period. Moreover, the benefits of formalizing these arrangements—in terms of financial assistance and access to South African financial markets—are great

enough that a reasonably pragmatic government in Windhoek would probably join permanently. As such, it would continue to rely on South Africa for the collection of customs duties and for setting most of its monetary and trade policies. On the other hand, the creation of a Namibian currency would be an important, yet inexpensive, gesture of independence that is allowed under the terms of the RMA. 25X1

Although an independent Namibia probably would choose to join the Southern African Development Coordination Conference (SADCC), membership would not be a workable substitute for continued economic relations with South Africa. The SADCC countries themselves have troubled economies and foreign exchange shortages. Namibia might be able to use SADCC membership to obtain additional funding for the capital projects and training that could eventually reduce economic dependency, but the poor track record of the existing SADCC countries in reducing economic ties to South Africa and the massive size of the task involved in Namibia's case, do not bode well for near-term prospects of such a course of action. An independent Namibia, even SWAPO led, would have few options to making peace, however uneasy, with Pretoria 25X1

Appendix C

Southern African Development Coordination Conference: Striking Out On Its Own

The SADCC was formally created in April 1980 by the heads of state of nine southern and eastern African nations with the goals of reducing economic dependence, especially on South Africa; promoting greater regional economic integration; and mobilizing donor support for priority projects.[5] After five years, however, the SADCC is further than ever from achieving the first two of its goals, in our view. Poor economic policy choices, drought, and low world prices for the region's major commodity exports have combined to boost economic dependence on South Africa, Western donors, and policy advice from organizations such as the IMF. Despite some reduction in dependence on South African communications facilities, transport dependence in particular has grown as insurgency and general economic decline have made alternate routes through Angola and Mozambique unreliable. SADCC trade with South Africa is some seven times greater than trade among SADCC countries, according to press reports.

SADCC has achieved somewhat more success in attracting donor contributions. According to SADCC estimates, donors have spent or committed $1 billion. Although this represents only about 20 percent of the cost of all SADCC projects, based on press reports, it still is a reasonable achievement considering that the SADCC "action program" virtually is a shopping list of possible projects. The most successful sectors for attracting donor contributions have been transport and communications. Some $720 million has been contributed or committed for road, rail and air transportation, ports, communications facilities, and pipelines. For other sectors, including energy, agriculture, trade, industry, and tourism, fewer donor commitments have been obtained, and most of the projects to date have focused on research rather than capital projects, according to press reports and academic studies.

Prospects for greater trade among SADCC countries is constrained by the foreign exchange shortages that they are experiencing. Even bartering commodities to avoid the use of foreign currency would not greatly boost their trade potential, in our view, because the SADCC countries have similar export and import patterns. In particular, Angola, Botswana, Swaziland, Tanzania, and Zambia each depend heavily on one or two commodity exports that would be of little value to their neighbors, while Lesotho is primarily an exporter of mine labor to South Africa. Zimbabwe is an exception in this respect, having a broader base of manufactured goods for export, as well as surplus grain that is much needed by neighboring states and can be purchased with foreign currency made available by donor nations. The black states of southern Africa, however, have little foreign exchange available for purchasing manufactured goods from Zimbabwe. Moreover, in the case of Botswana and Zimbabwe, where trade prospects are perhaps the greatest, 25X1
Harare has moved to protect domestic industry from competition in Botswana, claiming that many Botswana products are in fact of South African origin, according to press reports. 25X1

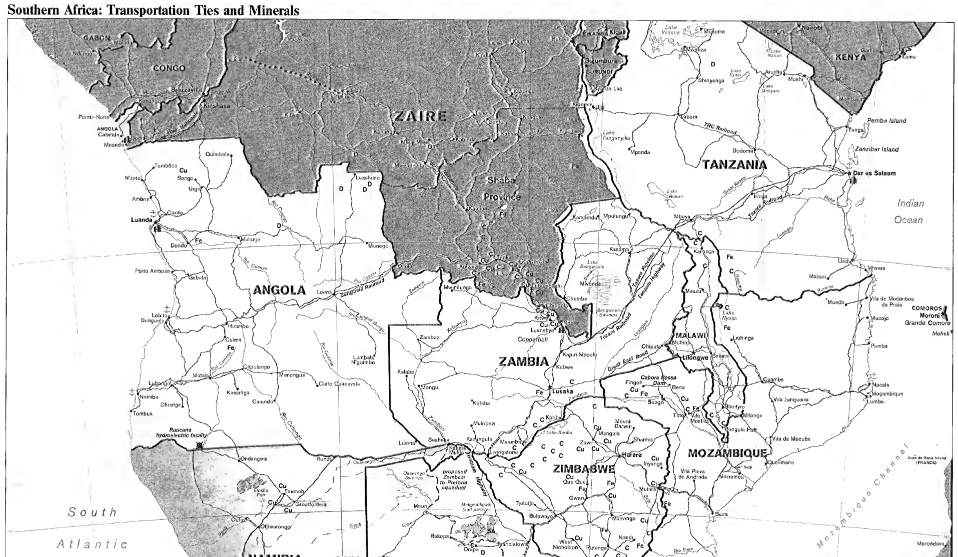
Even though Zimbabwe probably will usurp temporarily South Africa's traditional role as food supplier to the region, efforts by SADCC to promote long-term food security independent of South Africa are barely in the planning stage, and will require greater technical, financial, and administrative resources than are likely to be available. As a result, for the foreseeable future, we believe that years of poor rainfall will mean continued regional dependence on imported food, including that from South Africa. 25X1

25X1

[5] The SADCC countries are Angola, Botswana, Lesotho, Malawi, Mozambique, Swaziland, Tanzania, Zambia, and Zimbabwe. 25X1

One promising area for new regional economic ties among SADCC countries appears to be in hydroelectric development and integration of national electric grids. Southern Africa has adequate energy supplies to meet most of the needs of its modern sector, according to academic studies. Development of the full hydroelectric potential, however, will require participation of South Africa, with its comparatively huge electricity demand, in order to build facilities large enough to be economically viable. 25X1

Southern Africa: Transportation Ties and Minerals



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